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Ground Lease Financing: 3 Tips for Lenders, Landlords, and Tenants to Achieve a Win-Win-Win Situation

Q: UNDER WHAT CIRCUMSTANCES WOULD AN ENTITY CONSIDER ENTERING INTO A GROUND LEASE?

BETH H. MITCHELL: Government entities, higher education, religious institutions, and other parties that expect to be around for a long time and own a valuable piece of real estate over which they don't want to relinquish control frequently consider ground leases. In a ground lease, the landlord can lease the property to a long-term tenant who will develop it and have all the responsibilities of ownership. Upon termination of the lease, the land and improvements will revert to the landlord. The tenant benefits because it receives long-term rights in highly desirable property. For example, in Boston, you see ground leases appearing in the Seaport, as new areas are being developed on land owned by governmental entities.

Q: WHAT ARE THE KEY CONCEPTS THAT LANDLORDS AND TENANTS SHOULD FOCUS ON DURING NEGOTIATIONS?

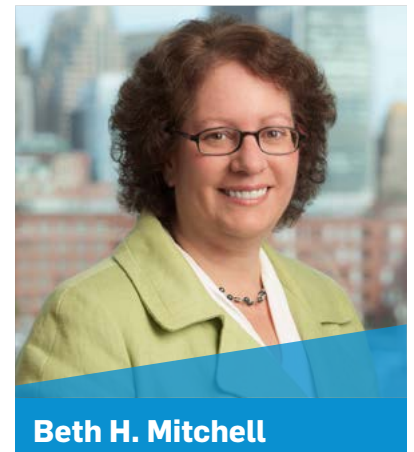
BHM: For sites where the ground lease is leading to new development, issues often arise over the control the landlord will have over the tenant's project; what rights the landlord may have to terminate the ground lease if the development encounters significant delays; how rent will be calculated during the term of the ground lease; what the landlord's and tenant's respective rights and obligations (including rebuilding obligations) are in the event of a casualty or condemnation; and when the landlord has the right to terminate the ground lease due to a tenant default.

Q: SHOULD LENDERS REQUIRE ANY SPECIAL PROVISIONS WHEN PROVIDING FINANCING FOR GROUND LEASE TRANSACTIONS?

BHM: Because a leasehold lender's collateral is only as good as the existence of the ground lease, lenders will want to limit the instances in which a landlord can terminate the ground lease. Lenders should seek notice and cure rights to protect against any possible termination of the ground lease and the right to a substitute or new ground lease if the tenant's ground lease is terminated for any reason. Lenders must also protect themselves in the event either the landlord or tenant files for bankruptcy, since bankruptcy can adversely affect the existence of the ground lease.

Q: COULD YOU OUTLINE THREE TIPS FOR LENDERS, LANDLORDS, AND TENANTS EXPLORING GROUND LEASES?

BHM: First, landlords should think strategically about where a ground lease might make sense. For example, a university may wish to take land not used directly for educational purposes to create areas that are symbiotic, such as tech or lab spaces where students, faculty members, and companies interact. Second, because ground leases typically have terms of up to 99 years, landlords and tenants need to consider all the various circumstances that might change over such a long period of time. For instance, in the last 99 years there have been huge technological advances affecting building design. Ground leases need to have enough flexibility to allow for appropriate adaptation. Third, lenders should seek appropriate protections from landlords (through estoppel and recognition agreements) to minimize their risks from matters adversely affecting their collateral.



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